

MEMORANDUM OF LAW

DATE: October 2, 1992

TO: Susan Hamilton, Deputy Director, Clean Water
Program

FROM: City Attorney

SUBJECT: Otay Mesa Trunk Sewer Reimbursement Agreements and
Proposed Otay Valley Water Reclamation Plant

By memorandum dated May 29, 1992, you requested that this office advise on several hypothetical questions which have arisen from the plans of the Clean Water Program to build an Otay Valley Water Reclamation Plant. Basically, there is a concern that a diversion of Otay area wastewater flows to the proposed reclamation plant would reduce or eliminate flows through an existing trunk sewer system which is owned by the City of San Diego subject to reimbursement agreements with non-City developers. The questions pertain to the City's rights and obligations under agreements with the Otay International Corporation (OIC) and the California Department of Corrections (CDC). Before addressing the questions, it would be helpful to first review the terms of those agreements and the configuration of the trunk sewer system. The legal analysis of the questions revolves entirely on interpretation of those agreements.

A. The Otay Mesa Sewer Construction and Operation Agreement

The design, planning, construction, and financing of existing sewerage facilities known as the Ultimate Otay Mesa Trunk Sewer System is covered by the Otay Mesa Sewer Construction and Operation Agreement, approved by the City Council on March 12, 1984 (Document No. R-260277). This comprehensive agreement called for execution of collateral agreements between its signatories for developer financing and construction of the sewer facilities, and for the City's reimbursement to those developers according to beneficial share. The principal signatories, in addition to the City of San Diego, are OIC and CDC. The collateral agreements are participation or reimbursement agreements executed between the City and those two developers. The following discussion considers only the OIC and CDC

reimbursement agreements, these being of priority because they concern the most significant components of the Ultimate Otay Mesa Trunk Sewer System.

B. The Otay International Corporation Agreement

The major portion of the Ultimate Otay Mesa Trunk Sewer System was financed, designed, and built by OIC pursuant to the Otay Mesa Sewer Facilities Participation Agreement (Document No. RR-264173, The "OIC Agreement"). The facilities constructed by OIC consist of: 1) The Otay Mesa Trunk Sewer; 2) The Otay Mesa Pump Station and Force Main; and 3) The Otay Valley Trunk Sewer. (Paragraph 5.)F

Paragraph numbers refer to sections of the subject Agreement at issue in the discussion.

The Otay Mesa Trunk Sewer extends westerly from the property of OIC to the pump station, which pumps effluent northerly through the force main to a connection with the Otay Valley Trunk Sewer, which runs northwest then westerly to an ultimate connection with the South Bay Metro Interceptor in Chula Vista. (See project plat map, Document No. RR-264174.) The OIC Agreement calls for reimbursement to OIC from the City according to terms discussed in more detail below.

The City is to obtain funds to make these reimbursement payments by charging for new connections to the system. Any connection to the above described facilities would require payment of the regular sewer capacity charge mandated by San Diego Municipal Code section 64.0410. Additionally, for any property generating sewage that will flow through any part of either trunk sewer, a capacity surcharge of \$450 per dwelling unit (plus interest at 6% per year) must be paid. ¶Paragraph 7(a); Resolution No. RR-260280.σ Further, for any property generating sewage that will flow through any part of the pump station or force main, a reimbursement charge of \$201.70 (increased 10% per year) must be paid. ¶Paragraph 7(b), (c).σ The capacity surcharge and reimbursement charge are assessable to any trunk sewer or force main/pump station users regardless of whether the connected property is within or without the boundaries of the benefitted area delineated on the plat map. ¶Paragraph 7(a), (b).σ

Paragraph 8(a) provides that reimbursement to OIC shall take precedence over any other reimbursement agreements for sewer projects on Otay Mesa. That subsection also describes the various phases of the OIC project and the maximum total estimated amount to be reimbursed for each phase, though actual construction costs are the basis for actual reimbursement (Paragraph 15).

Very significantly, paragraph 8(c) discloses that OIC is not guaranteed full reimbursement for all components of the system. Paragraph 8(c) provides:

Except as provided in Paragraph 15 herein, OIC hereby acknowledges that there are no assurances it will receive the full amount of the above maximum reimbursements or even any portion thereof. In no event will OIC receive more than the actual audited costs plus interest.
(Emphasis added.)

Naturally, this acknowledgement of "no assurances" must be read along with Paragraph 15, which provides the exception. Paragraph 15 reads in relevant part:

Notwithstanding any other provision
i.e., the "no assurances" provision
of Paragraph 8(c), City shall
reimburse OIC one hundred percent
(100%) of actual construction costs,
excluding planning, design, legal and
administrative fees and right-of-way
acquisition, for Phases IA, IB, II
and III. ¶Reference to Paragraph
8(c) added.σ

According to paragraph 5, Phases IA, IB, II, and III constitute the entirety of the Otay Valley Trunk Sewer. The general significance of the agreement may therefore be reduced to the conclusion that OIC, pursuant to Paragraph 8(c), has no guarantee of reimbursement for its expenditures on the Otay Mesa Trunk Sewer, nor for the pump station or force main; however, pursuant to Paragraph 15, OIC does have the right to 100 percent reimbursement for its construction expenditures on the Otay Valley Trunk Sewer.

OIC's right to reimbursement for the Otay Valley Trunk Sewer has no time limitation. Section 16 states that "¶except as provided in Paragraph 15 above, reimbursement to OIC and its successors-in-interest shall be made only from those amounts collected by City pursuant to this Agreement prior to July 1, 2006." This limitation does not apply to the Otay Valley Trunk Sewer, as Paragraph 15 expressly excepts that reach of the system and provides for 100% reimbursement of its construction costs. On the other hand, the OIC Agreement is also silent on the question of how soon that reimbursement is due.

It can be reasonably inferred that the reason why OIC is

guaranteed reimbursement for the Otay Valley Trunk Sewer, but not for the Otay Mesa Trunk Sewer, pump station, or force main, is that the latter facilities more directly and exclusively benefit OIC, whereas the Otay Valley Trunk Sewer would be expected to have more shared benefit with future development.

C. The California Department of Corrections Agreement

The Otay Mesa Sewer Facilities Participation Agreement with the State of California (Document No. R-264609, the "CDC Agreement") is second in reimbursement priority to the OIC Agreement. The CDC, pursuant to its agreement, constructed an extension sewer which runs northwest then west from the CDC property, and ultimately connects to the Otay Valley Trunk Sewer built by OIC. The CDC extension sewer is a component of the Ultimate Otay Mesa Trunk Sewer System, and as such, the capacity surcharge of \$450 per dwelling unit established by Resolution No. R-260280 may be assessed on any property generating sewage which flows through any part of it. ¶Paragraph 3(a).σ However, although surcharges may be collected for connections to the CDC extension sewer, those revenues are dedicated to the OIC agreement as a first priority. Thus, CDC has no entitlement to reimbursement until OIC has been reimbursed for all of the facilities it constructed, including the Otay Mesa Trunk Sewer, pump station and force main. ¶Paragraph 5(a).σ

Once OIC has been fully reimbursed, all surcharge revenues then will be divided as follows: 25 percent to CDC as reimbursement for the extension sewer; 3.63 percent to the City as reimbursement for cost of oversizing the pipe. Pursuant to Sewer Service Agreement with the California State Prison (Document No. R-263922), CDC installed a larger pipe than was required for its own use. The City acquired this extra capacity to serve future development unrelated to that of the CDC. Thus, the City has paid CDC 12.68 percent of the total cost of the extension sewer for this oversizing. This was to be based on actual costs, but the City advanced \$261,000 as a deposit toward those costs. See, Section 2(d) of the Service Agreement.

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administration of the reimbursement agreements; and 71.37 percent to finance construction of additional trunk sewers or to reimburse any developers (other than CDC or OIC) who constructed other portions of the trunk system. ¶Paragraph 5(b).σ After all reimbursements to developers other than CDC are complete, then 50 percent of all remaining surcharge revenues are to be paid to CDC until CDC is fully reimbursed. ¶Paragraph 5(c).σ

It is significant to note that the City's duty to reimburse CDC is limited to those amounts the City actually collects

pursuant to the CDC agreement, i.e., only to the extent it collects connection charges. And again, this duty only arises after all reimbursement is made to OIC for the construction of the trunk sewers. ¶Paragraph 6.σ The only exception to these limitations would apply in a situation where the City's collection of the charges is held to be invalid as a result of legal action ¶Paragraph 15σ. Although this possibility is unlikely, the parties then would be required to "explore and take such measures as are reasonably available to them to generate funds to make the reimbursements of principal plus interest which the parties intend occur." Id. If no source can be identified within a year following an injunction on the City's collection of charges for connection to the extension sewer, then CDC may have a right to a portion of the reimbursement due to the City pursuant to the OIC agreement, if any. Id.

As for duration of the City's duty to reimburse CDC, the agreement provides that the obligation extends to the thirtieth (30th) anniversary of the date of the first reimbursement payment made to CDC (the year 2015 at earliest), or until CDC has been fully reimbursed, whichever comes first ¶Paragraph 17σ.

D. The Hypothetical Issues

Hypothetical 1:

The City diverts wastewater flows from the trunk sewers to the water reclamation plant, thereby limiting wastewater flows in the Otay Valley Trunk Sewer.

In this situation, the City would not necessarily forego collection of reimbursement revenues. Note should be given to the fact that reimbursement revenues will derive from any property which generates sewage which will flow through any part of the trunk sewer system. Thus, if a property generates sewage which flows through even a short distance of the trunk system before being "diverted" to the proposed reclamation plant, the capacity charge and surcharge may be assessed. This would also hold true for any connections to the extension sewer built by CDC. The fact that flows may not pass so far west as to reach the Otay Valley Trunk Sewer, or even any part of it, is of no significance to the collection of reimbursement revenues if more easterly sections of the trunk system are utilized prior to diversion.

The use of the verb "divert" in the hypothetical could imply that flows will pass through some section of the trunk system before being directed to the reclamation plant; however, the term could also be taken to imply a diversion through a new line completely independent of the trunk system. In the prior instance, reimbursement revenues could be collected, whereas in

the latter they could not. If the trunk system is utilized at all, OIC and CDC may be reimbursed in the exact manner set forth in their agreements. Moreover, although OIC has no assurance of reimbursement for the pump station and force main, if a property generates flows which pass through these prior to diversion to the plant, the OIC reimbursement charge may be collected.

If any future developer does connect through such a short reach of the existing trunk before the flow is diverted to the reclamation plant, it is possible that the City's right to collect the OIC reimbursement charges could be contested. In such an event, OIC would have the option of either waiving collection of the charges, or assuming the defense and costs of the challenge ¶Paragraph 19σ. If the challenge is successful, the City is to be without any further obligation to OIC ¶Paragraph 20σ. Thus, even in the off chance the City's right to collect assessments for any use of the trunk system is challenged, the City remains at no risk of liability to OIC.

Hypothetical 2

The City allows a private developer to construct a new sewer directly to the water reclamation plant, bypassing both the CDC and OIC sewers.

This situation would certainly disallow the City the ability to assess reimbursement surcharges for the Ultimate Otay Mesa Trunk Sewer System, since that system would be completely bypassed. The possible legal consequences of this hypothetical could be described as follows: OIC could arguably claim that the City is liable to it for the balance of construction costs for the Otay Valley Trunk Sewer, because OIC is entitled to 100% reimbursement of these costs pursuant to paragraph 15 of its agreement. (No interest on this amount may be claimed as provided by paragraph 8(b)iv.) The City might counter such an argument by asserting 1) that its duty to reimburse extends only to its actual collection of charges and surcharges, and that it is not obligated to reimburse from any other revenue source; and/or 2) there is no due date specified in Paragraph 15 for reimbursement of the Otay Valley Trunk Sewer construction costs, and since surcharges potentially could be assessed for future connections, diversion of some flows to the reclamation plant through an independent line would not constitute a breach of the agreement.

Also, OIC would not have any claim in this situation for reimbursement for the Otay Mesa Trunk Sewer, pump station, or force main. Although the OIC agreement does contemplate reimbursement for those components of the system, paragraph 8(c) expressly makes clear that there are "no assurances." And since

reimbursement to CDC is a second priority to OIC's full reimbursement for those components of the system as well, CDC would not have any viable legal claim either. In a strictly legal sense, then, this hypothetical may provide OIC with a claim for the Otay Valley Trunk Sewer costs only, and not for the other components it constructed. Further, if OIC is not fully reimbursed for all components, CDC would have no claim under its junior agreement.

Hypothetical 3

A private developer constructs a separate sewer to serve Salt Creek, which parallels the OIC and CDC lines and connects directly to the City's South Bay Metro Interceptor.

Without question, this scenario would preclude the City's collection of reimbursement revenues. It is noted that the Otay Valley Trunk Sewer built by OIC runs along the northern border of the Otay property which is within the jurisdictional limits of the City of San Diego. The benefitted area identified as the expected source of reimbursement revenues in the OIC agreement lies almost entirely south of the Otay Valley Trunk Sewer. See plat map. Although the OIC agreement states that the surcharge may be assessed to any property using the system regardless of whether it is outside the benefitted area, it is clear that OIC should not have a strong expectation of the City's ability to collect surcharges from property outside that benefitted area.

The reason for this is easily understood. The Salt Creek area where the hypothetical parallel sewer would run is immediately north of the benefitted area, and is within the jurisdictional limits of the City of Chula Vista or unincorporated areas of the county. The City of San Diego has little control over the planning decisions made in Chula Vista. If Chula Vista allows a developer to construct its own sewer line, and establishes an arrangement with that developer similar to the one between OIC and San Diego, we do not believe there is viable legal argument for San Diego to prevent it. If the City of Chula Vista has sufficient excess capacity rights in its agreement with San Diego as a participating agency in the Metro System, Chula Vista could make the connection to the Metro Interceptor and contract that capacity to the developer. The only limitation on such a connection would be that it be at a point agreed upon in Chula Vista's participating agency agreement.

This situation, we believe, would not leave San Diego in a position of liability to OIC or CDC. Salt Creek is outside the OIC benefitted area because it lies outside San Diego's territorial limits. As such, OIC and CDC could not reasonably

expect that San Diego could control development decisions in Chula Vista, and we believe this is why the benefitted area was delineated as it is.

Hypothetical 4

A private developer constructs a separate sewer to serve the developer's development and wishes to make a "temporary" connection to the lines built by OIC or CDC lines that are covered by the reimbursement agreements.

The prospect of temporary connections was not contemplated by the reimbursement agreements. We have the opinion that any connection to the OIC or CDC lines, even "temporary," would be subject to the surcharge. Paragraph 9 of the OIC agreement provides that surcharges and reimbursement charges are to be collected at the time of permitting connection. A private developer certainly would have no right to connect for less compensation than set forth in the OIC agreement, as that agreement is clear that the full surcharges may be assessed to any property generating sewage which will flow through any part of the Otay Mesa Trunk Sewer System. We believe that any connection, however short, should be assessed as is expected by the OIC agreement. And as earlier stated, any challenge to the City's right to collect those assessments would fall to OIC for defense, and if the challenge was successful, the City is to be held harmless.

E. Summary of Hypotheticals and Conclusions

Hypotheticals 1 and 4 presume that some connection will be made to the Ultimate Otay Mesa Trunk System, and according to Paragraph 9 of the OIC agreement and Paragraph 3(a) of the CDC agreement, reimbursement assessments could be made. These two possibilities therefore would not likely provide OIC or CDC with the basis for making a claim that the City breached its agreement to collect reimbursement charges. Hypothetical 3 describes a situation over which the City has little control, and involves a geography which is outside both the City limits and the benefitted area described in the OIC and CDC agreements. OIC and CDC thus would not likely have successful claims against the City in that situation. Hypothetical 2 (direct connection to the reclamation plant) presents the most significant concern for City liability, because the realization of that situation is within the City's discretionary power, and it would preclude collection of reimbursement revenues.

It appears quite clear that when the OIC and CDC agreements were executed, all parties fully intended that the trunk sewer system would eventually serve the needs of the entire Otay area by conveyance of all wastewater to the Metro Interceptor. The

prospect that Otay sewage would be treated at a local water reclamation plant evidently was not considered at all. Consequently, OIC and CDC placed a great deal of reliance on City intentions which underlie their agreements, and this reliance raises a concern for equity if an injury is caused by the City's later alteration of those intentions. The minimum assurance and original intent was reimbursement to OIC for the construction costs of the Otay Valley Trunk sewer. If the City were to permit direct connections to the proposed reclamation plant, that minimum expectation might not be met, let alone the larger plan for full reimbursement of all trunk system developers.

In order to minimize potential claims, we advise that should the City decide to permit direct connections to the reclamation plant, then it ought to consider the assessment of a surcharge for that benefit. The benefit would be the avoidance of the trunk sewer surcharges, and the trunk sewer itself would serve as a redundant system in the event the reclamation plant is for some reason unable to accommodate flows. In equitable reciprocity then, the assessments from the reclamation plant may be dedicated to reimbursement of OIC. While both CDC and OIC have no legal right to full reimbursement of all expenditures, OIC does have a minimum expectation for the Otay Valley line, and the City should ensure that its obligation in this respect is discharged.

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